

# ORIGINAL OPEN MEETING



## MEMORANDUM RECEIVED

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TO: THE COMMISSION

FROM: Utilities Division

AZ CORP COMMISSION  
DOCUMENT CONTROL

DATE: June 15, 2005

RE: IN THE MATTER OF THE APPLICATION OF VALLEY CONNECTIONS, L.L.C.  
FOR AUTHORIZATION TO ASSUME NEW DEBT (DOCKET NO. T-04169A-04-0816)

### Introduction

Valley Connections, L.L.C. ("Valley" or "Company") filed an application with the Arizona Corporation Commission ("Commission") on November 12, 2004, requesting authorization to assume new long-term debt of \$14,956,743.

### Background

Valley was incorporated on January 20, 2000, as a perpetual domestic limited liability company. Valley Telephone Cooperative, Inc. ("VTC") is the manager while Copper Valley Telephone, Inc. ("Copper") and VTC are members. Copper is a wholly owned subsidiary of VTC. Valley is owned 50 percent by VTC and 50 percent by Copper.

Valley was issued a certificate of convenience and necessity ("CC&N") to provide facilities-based competitive local exchange telecommunications services in Cochise, Graham, Greenlee, Santa Cruz, and Pima Counties, Arizona in Decision No. 66846, dated March 12, 2004.

### Purpose of Financing

Valley requests debt financing authorization in the amount of \$14,956,743. Valley proposes to use the proceeds to connect a potential of 2,305 new broadband subscribers in the communities of Willcox, Safford, and Thatcher, to install a new video head end facility in Willcox, to install new fiber optic cable facilities in underground duct, to install network and access equipment, to purchase customer premises equipment, and to provide for engineering services.

### **Description of Proposed Financing**

The proposed financing is to be a long-term credit facility with a fifteen-year amortization from the date of the first loan advance. All loan advances are expected to be made in 2005. The expected loan rate is 5.50 percent per annum. However, authorization is requested for rates as high as 7.5 percent per annum to recognize the potential for loan rates to rise prior to funding from the United States Department of Agriculture, Rural Utilities Service ("RUS").

### **Financial Analysis**

Staff utilized the December 31, 2003, consolidated financial statements for VTC, pro forma projections provided by Valley and pro forma financial information prepared by Staff for the analysis of the loan request. Staff first evaluated the effects of the loan upon the consolidated entities. Consolidated financial information is presented on Schedule JJD-1.

Valley has no current operations. Initial capitalization of Valley is to come from a cash contribution of \$2,738,282, an RUS requirement, and transfer of assets from Copper. The in-service assets are valued by Copper at \$587,360 giving initial capitalization of \$3,325,642. According to the application, both VTC and Copper offer full financial support of Valley however, "neither Valley Telephone Cooperative nor Copper Valley Telephone will provide a guarantee to RUS for Valley Connections, L.L.C.'s debt".<sup>1</sup>

#### **Consolidated Analysis**

Schedule JJD-1 attached, uses financial information from the consolidated financial statements for the period ending December 31, 2003, for VTC and subsidiaries. Column A shows the consolidated entity at December 31, 2003, without the proposed new debt. The results of operations for the year then ended produced a times interest earned ratio ("TIER") of 1.34 and a debt service coverage ratio ("DSC") of 1.47. The highly leveraged capital structure as shown in Column A is composed of 31.5 percent equity, 64.2 percent long-term debt, and 4.4 percent short-term debt.

Column B of Schedule JJD-1 shows the changes that would be the result of imposition of the proposed debt of \$14,956,743 at a 5.50 percent interest rate with a fifteen-year amortization. This methodology is a stress test in that no revenues from the new venture are recognized. Imposition of the proposed debt reduces TIER to 1.05 and DSC to 1.23 and degrades the capital structure to 68.2 percent long-term debt, 4.4 percent short-term debt, and 27.4 percent equity. This pro forma capital structure is excessively leveraged and the resulting TIER and DSC are marginal. The RUS DSC requirement is 1.25 based on the average of the two highest of three years. Staff's analysis shows that the ability of VTC and subsidiaries to meet the minimum requirements of their lender is questionable. VTC and Copper are not obligated to meet such requirements.

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<sup>1</sup> Response to Data request JHJ-2.2

DSC represents the number of times internally generated cash will cover required principal and interest payments on long-term debt. A DSC greater than 1.0 indicates that operating cash flow is sufficient to cover debt obligations.

TIER represents the number of times earnings will cover interest expense on long-term debt. A TIER greater than 1.0 means that operating income is greater than interest expense. A TIER less than 1.0 is not sustainable in the long term but does not necessarily mean that debt obligations cannot be met in the short term.

#### Stand Alone Analysis

Schedule JJD-2 presents financial information for Valley on a stand-alone basis. Table 1 of Schedule JJD-2 was prepared using Valley's five year pro-forma projections as of the end of each of the years of operation with the DSC provided by Staff. Table 1 assumes the loans are funded over a 9 to 15 month period. Table 2 is Staff's pro-forma prepared using the financial information in Table 1 adjusted to reflect the proposed loans as in existence for the entire first year. Table 2 shows Valley's lack of ability to repay principal and interest on a stand-alone basis until the third year of operation. Table 3 presents Valley's Capital Structure composed of equity and debt based on the Company's pro forma projections which include current maturities of long-term debt. Table 3 shows pro forma capital structures for Valley for the years 2005 to 2009. The projections show Valley's equity position varying between 4.94 percent and 16.8 percent. This is an excessively leveraged capital structure.

Valley's ability to achieve the projected operating results presented in Schedule JJD-1 and JJD-2 is dependent upon its success marketing the new fiber optic system and connecting customers. Even if Valley meets its projections it will not generate sufficient revenue to cover debt service in the first two years of operation.

The Company has indicated that construction will be done in discrete phases and will provide a barometer as to whether the required customer penetration is achievable. This phase approach offers some mitigation of the project's risk. The Company will continuously monitor and evaluate its financial success during each phase before entering a new service area.

#### Public Interest Analysis

The Company has broad community support for this project including Graham County Chamber of Commerce, the City of Wilcox, the Wilcox Chamber of Commerce and Agriculture, and Northern Cochise Community Hospital. The Company indicates a potential customer base of over 2,000 subscribers in the eligible communities of Willcox, Safford and Thatcher.

Staff concludes that, absent the RUS loan, broadband services for these communities would not appear to be economically viable.

The RUS has approved the Company's loan request. The RUS Rural Broadband Loan program has approximately \$2 billion available in fiscal 2005. The program offers direct loans and loan guarantees for the construction, improvement and acquisition of facilities and equipment for broadband service in eligible rural communities.

The Rural Broadband Loan program is intended to provide broadband access to rural communities to enhance opportunities for economic development and assist communities in meeting public safety needs.

More than \$30 million in three years have been invested by USDA Rural Development to open the door to broadband infrastructure through the Community Connect Broadband Grant Program. To date, more than 90 communities have participated in the program to connect essential services to police and fire protection, local government, hospitals, libraries and schools to broadband service. USDA Rural Development's mission is to deliver programs in a way that will support increasing economic opportunity and improve the quality of life of rural residents.<sup>2</sup>

### **Compliance**

This is a new entity that has not begun operations so there is no record of compliance or non-compliance.

### **Engineering Analysis**

The Staff engineering report, attached, concludes that the capital improvements are appropriate for the types of services that Valley plans to provide to customers in the Willcox and Safford/Thatcher areas.

Staff further concludes that the costs associated with the project appear to be reasonable.

### **Staff Conclusions and Recommendations**

Staff concludes that the issuance of debt in the amount of \$14,956,743 on the terms described is within the corporate powers of the applicant.

Staff further concludes that the costs associated with the project appear to be reasonable.

Staff further concludes it would not recommend approval for the issuance of any debt absent the RUS approval and a clear public interest at hand.

Staff concludes that, absent the RUS loan, broadband services for these communities would not appear to be economically viable.

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<sup>2</sup> USDA Press Release, March 29, 2005.


THE COMMISSION

June 15, 2005

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Therefore, Staff recommends approval of the applicant's request for authorization to incur \$14,956,743 of debt financing, subject to the following conditions:

1. Valley Telephone Cooperative, Inc., Copper Valley Telephone, Inc. or any other affiliated entity may not guarantee the subject RUS debt.
2. Valley Telephone Cooperative, Inc., Copper Valley Telephone, Inc. or any other affiliated entity may not provide further funding to the Company.
3. The Company will docket for Staff's review a report within 30 day of completion of the first phase of construction as to costs incurred versus estimated amount and customer penetration versus estimated penetration.
4. Books and records for the Company will be maintained separately from affiliated entities and annually provide a balance sheet, income statement, statement of stockholder's equity and footnotes.
5. Staff recommends approval without a public hearing.

*for*   
Ernest G. Johnson  
Director  
Utilities Division

EGJ:JJD:lhv\DR

ORIGINATOR: James J. Dorf

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**BEFORE THE ARIZONA CORPORATION COMMISSION**

JEFF HATCH-MILLER  
Chairman  
WILLIAM A. MUNDELL  
Commissioner  
MARC SPITZER  
Commissioner  
MIKE GLEASON  
Commissioner  
KRISTIN K. MAYES  
Commissioner

IN THE MATTER OF THE APPLICATION  
OF VALLEY CONNECTIONS, L.L.C. FOR  
AUTHORIZATION TO ASSUME NEW  
DEBT

DOCKET NO. T-04169A-04-0816  
DECISION NO. \_\_\_\_\_  
ORDER

Open Meeting  
July 28, 2005  
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. Valley Connections, L.L.C. ("Valley" or "Company") filed an application with the Arizona Corporation Commission ("Commission") on November 12, 2004, requesting authorization to assume new long-term debt of \$14,956,743.
  2. Valley was formed on January 20, 2000, as a perpetual domestic limited liability company.
  3. Valley Telephone Cooperative, Inc. ("VTC") is the manager of Valley while Copper Valley Telephone, Inc. ("Copper") and VTC are members.
  4. Copper is a wholly owned subsidiary of VTC.
  5. Valley is owned 50 percent by VTC and 50 percent by Copper Valley Telephone.
  6. Valley was issued a certificate of convenience and necessity ("CC&N") to provide facilities-based competitive local exchange telecommunications services in Cochise, Graham, Greenlee, Santa Cruz, and Pima Counties, Arizona in Decision No. 66846, dated March 12, 2004.
- ...

14. Staff's engineering analysis concludes that the proposed capital improvements are appropriate for the types of service that Valley plans to provide to customers in the Willcox and Safford/Thatcher areas.

1           3.     The Commission having reviewed the application and Staff's Memorandum of  
2 June 15, 2005, concludes that it is in the public interest to grant the Company's request to borrow  
3 \$14,956,743 on the terms described.

4           4.     Valley Telephone Cooperative, Inc., Copper Valley Telephone, Inc, or any other  
5 affiliated entity may not guarantee the subject RUS debt.

6           5.     Valley Telephone Cooperative, Inc., Copper Valley Telephone, Inc, or any other  
7 affiliated entity may not provide further funding to the Company.

8           6.     The Company will be required to docket for Staff's review a report within 30 days of  
9 the completion of the first phase of construction as to costs incurred versus the estimated amount  
10 and customer penetration versus estimated penetration.

11                                 ORDER

12           IT IS THEREFORE ORDERED that the application be and hereby is granted.

13           IT IS FURTHER ORDERED that this Decision shall become effective immediately.

14           IT IS FUTHER ORDERED that Valley Telephone Cooperative, Inc, Copper Valley  
15 Telephone, Inc. or any other affiliated entity may not guarantee the subject RUS debt.

16           IT IS FURTHER ORDERED that Valley Telephone Cooperative, Inc, Copper Valley  
17 Telephone, Inc. or any other affiliated entity may not provide further funding to the Company.

18           IT IS FURTHER ORDERED that the Company will docket for Staff's review a report  
19 within 30 days of completion of the first phase of construction as to costs incurred versus the  
20 estimated amount and customer penetration versus estimated penetration.

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1 IT IS FURTHER ORDERED that the Company will maintain its books and records  
2 separately from affiliated entities and annually provide a balance sheet, income statement,  
3 statement of stockholder's equity and footnotes.

4 IT IS FURTHER ORDERED that this Order shall become effective immediately.

5  
6 **BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION**

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9 CHAIRMAN

COMMISSIONER

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12 COMMISSIONER

COMMISSIONER

COMMISSIONER

13 IN WITNESS WHEREOF, I BRIAN C. McNEIL, Executive  
14 Secretary of the Arizona Corporation Commission, have  
15 hereunto, set my hand and caused the official seal of this  
16 Commission to be affixed at the Capitol, in the City of  
17 Phoenix, this \_\_\_\_\_ day of \_\_\_\_\_, 2005.

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19 BRIAN C. McNEIL  
20 Executive Secretary

21 DISSENT: \_\_\_\_\_

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23 DISSENT: \_\_\_\_\_

24 EGJ:RGG:lh\DR  
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1 SERVICE LIST FOR: VALLEY CONNECTIONS, L.L.C.  
2 DOCKET NO. T-04169A-04-0816

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